U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

January 14, 2003

The Honorable David M. Walker
Comptroller General
U.S. General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Walker:

Foremost on the agenda of the Committee on Financial Services for the 108th Congress is restoring investor confidence and promoting the strength of our capital markets. The heart and soul of today's stock market is represented by middle-class American families working and saving for retirement, for their children's educations, to buy a home, and for other financial goals. And most individual and family American investors participate in the stock market through mutual funds.

An essential step to restoring investor confidence and the robustness of our markets is to ensure that market forces, through transparency and competition, help the 95 million investors who hold a stake in U.S. mutual funds to achieve their financial goals. While there is a great deal of competition among funds for shareholder dollars, we believe that greater attention to mutual fund fees would benefit investors. As John Bogle said in June 2001, "Despite the industry's staggering growth (from $2.5 billion 50 years ago to $7 trillion today), the expense ratio of the average equity fund has doubled (to1.6% of assets)."

While a fund's expense ratio may appear to represent just a small percentage of its total assets, the impact of these fees can be significant. For example, increasing an expense ratio from 1 percent to 2 percent on a $10,000 investment earning 8 percent annually can reduce an investor's total return by about $7,000 over a 20-year period. Many commentators have opined that expenses are the single most important factor to a shareholder's return.

Indeed, the GAO's report entitled "Mutual Fund Fees: Additional Disclosure Could Encourage Price Competition" (June 2000) highlighted the importance of fee transparency. We are writing to request that you perform a follow-up study to the June 2000 report. Please address the following issues in the report, in addition to any other matters you feel are relevant:

- Current trends in mutual fund fees, including but not limited to advisory fees, 12b-1 fees, sales loads, and other fees, broken down by category of fund and category of fees;

- Disclosure of mutual fund fees, including the effectiveness of disclosure placement, whether disclosure in shareholder statements would be advantageous, and the relative investor benefits of specific-dollar disclosure;
- The effectiveness and investor impact of new after-tax performance disclosure rules;
- Transparency of brokerage commissions paid on fund portfolio transactions, which some experts have estimated to average about 0.5 percent annually; the impact of those commissions on shareholder return; and the benefits of including these costs in the fund's expense ratio and otherwise improving the disclosure of this information to investors;
- The role of 12b-1 fees, and whether modifications may be needed to rule 12b-1 to reflect changes in the manner in which funds are marketed and distributed; the role of 12b-1 fees in so-called fund "supermarkets;" the effectiveness of rule 12b-1 in achieving the goal of "economies of scale" to investors; the role of 12b-1 fees in closed funds that no longer accept new investors; the relationship between 12b-1 fees and other distribution fees (such as sales commissions); and the role of so-called "defensive" 12b-1 plans;
- The role of fund directors, particularly independent directors, regarding fund fees, and the impact of directors, particularly independent directors, on fees since the adoption by most funds of a policy of having a majority of independent directors on their boards;
- The use by mutual funds of so-called "soft-dollar" brokerage arrangements; the regulatory oversight and transparency of such arrangements; and the impact of these arrangements on investors;
- The use by mutual funds of "directed brokerage" arrangements; the regulatory oversight and transparency of such arrangements; and the impact of these arrangement on investors;
- The role of fee transparency in fund advertising and fund competition; and
- The number of equity funds that commenced operations since 1997 that have since ceased operations or been merged into other funds, the performance records of those funds, and an analysis of whether such funds were highly concentrated in any particular industry sector.

Please provide this report no later than April 15, 2003. Also, please provide my staff with a briefing at your earliest convenience to discuss this project.

Yours truly,

Michael G. Oxley
Chairman

Richard H. Baker
Chairman
Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises